MENTENOVA

US-CHINA DECOUPLING

PART 1: THE GREAT RECALIBRATION

AUGUST 2025

Unravelling the world's biggest trade relationship

The United States and China have, over the years, had the most important yet complex bilateral relationship dating back to the early 1900s. In recent years, particularly since 2018, trade dynamics between the two countries have been defined by geopolitical tensions, trade wars and supply chain concerns. Their symbiotic relationship has been apparent, with the US depending on China for cost-effective manufacturing and a significant amount of its treasury holdings and China depending on the US for access to its large consumer market and high-tech components.

With hyper-globalisation at its peak and both nations working to reduce their mutual dependency due to political tensions, recognition of their strategic vulnerabilities has catalysed a deliberate, though asymmetrical, decoupling process. Recent data confirm this trend, with the US-China trade gap having narrowed. US exports to China and US imports from China have decreased (down by 40.8% and 41.5% YoY, respectively), signalling a tangible contraction in direct bilateral trade.

Figure 1: US-China trade gap

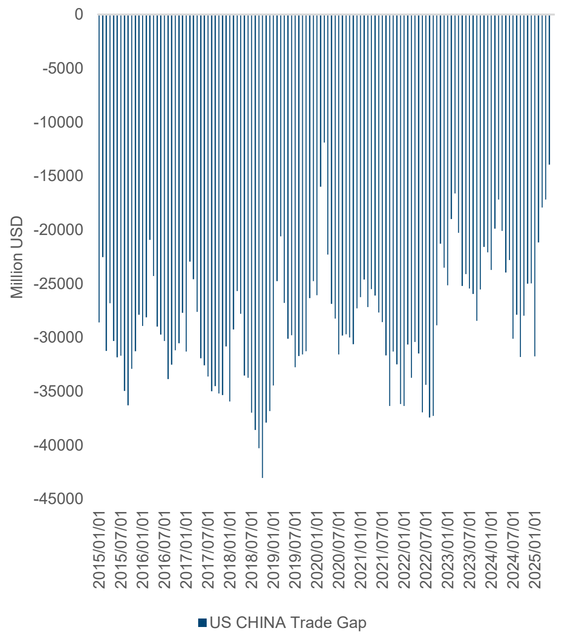
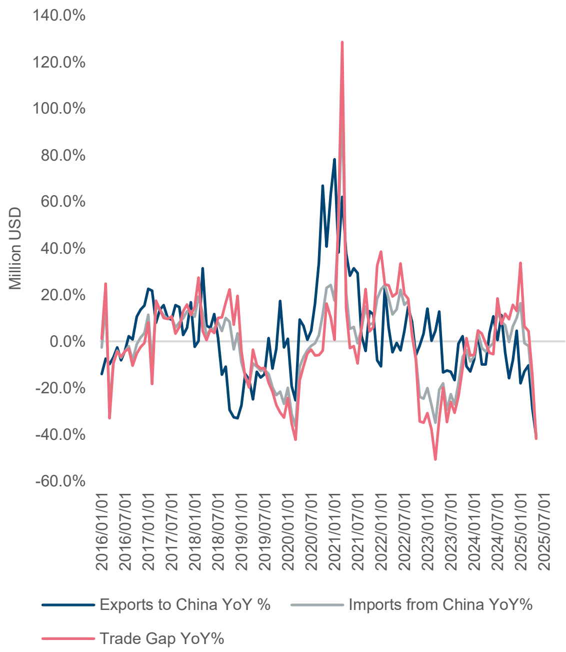


Figure 2: US imports from and exports to China

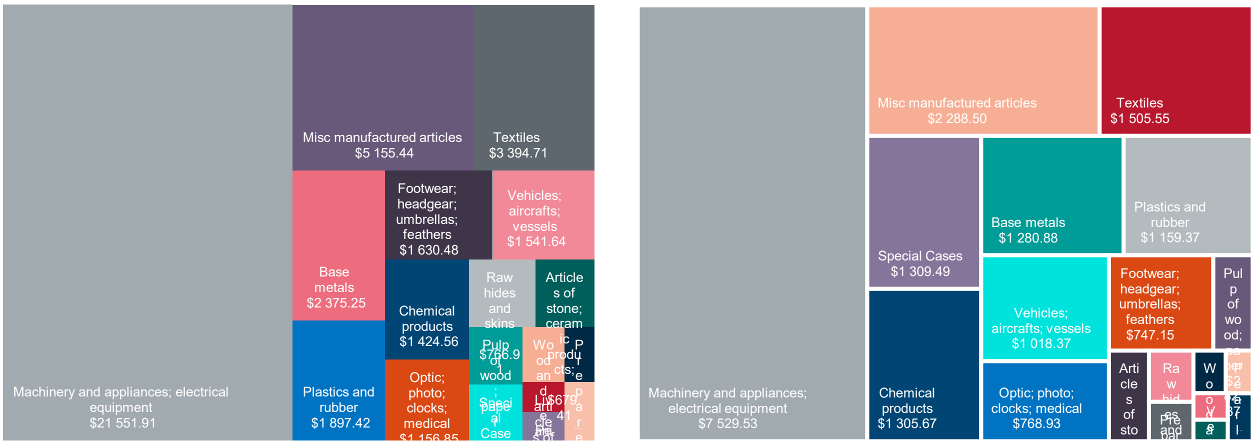


Source: Bloomberg

The evolution of this relationship is best understood by focusing not on the shrinking trade volumes alone, but also on the strategic shift in the composition of trade flows, which reveals the two nations' priorities and a significant change in the products exchanged. Products that the US imports from China have been radically reshaped, with a stark retreat from certain categories, most notably electronics and machinery, which have contracted by roughly two-thirds. This is not merely a reduction in consumption; it is a conscious pivot to alternative sourcing nations for commoditised goods like basic textiles and apparel. The narrative, however, is nuanced. While overall dependency is reduced, the US continues to source certain high-tech, difficult-to-replicate products from China, illustrating the practical challenges of a full-scale decoupling.

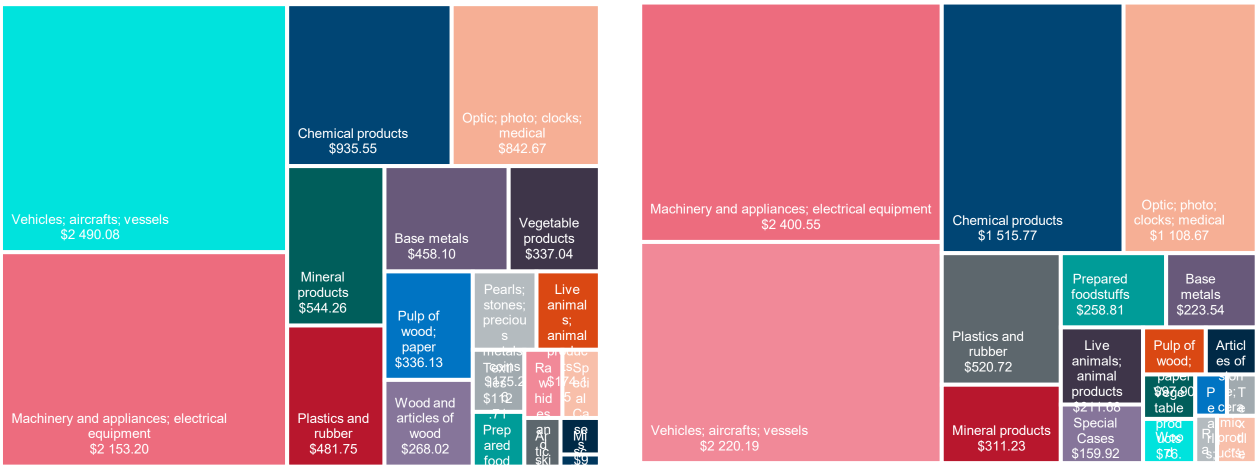
Mirroring this shift, US exports to China tell a story of a new strategic reality of a pronounced decline in exports of vehicles, aircraft and vessels as a direct result of China's successful industrial policy and growing domestic capacity in these sectors. Conversely, exports of machinery, electrical equipment and optical/medical instruments have gained prominence. This offers a crucial insight that the enduring US competitive advantage lies in high-value, complex manufactured goods, a dynamic that is further intensified by the ongoing global race for leadership in artificial intelligence and other frontier technologies.

Figure 3: US imports from China in 2017 vs 2025 (USD millions)



Source: Bloomberg

Figure 4: US exports to China in 2017 vs 2025 (USD millions)

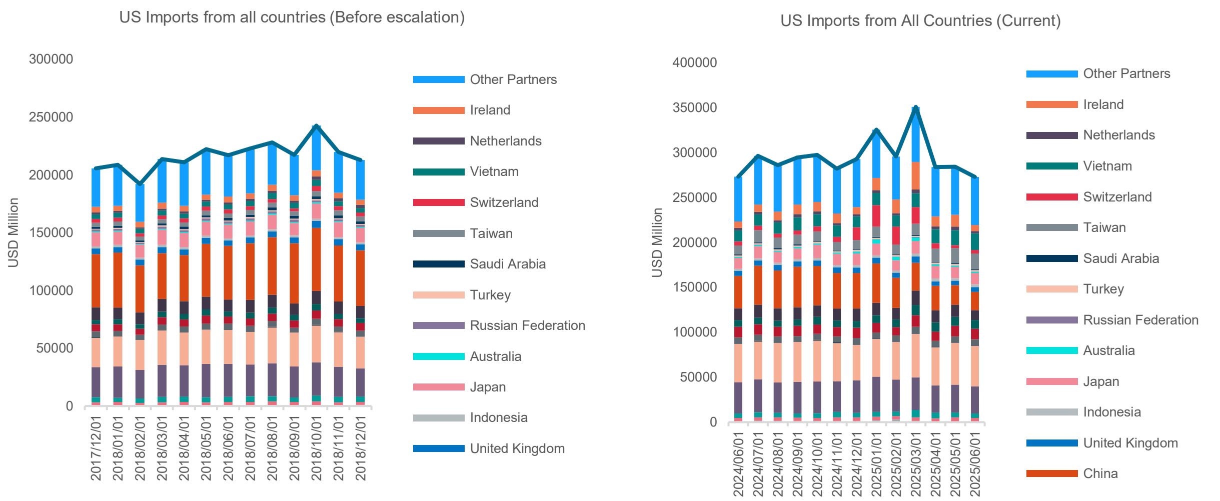


Source: Bloomberg

As the trade deficit between the US and China has shrunk, the critical question for investors and strategists is: where has the economic activity migrated to? The manufacturing base, once concentrated in China, has not returned completely to the US but has rather been dispersed across a network of allied and neutral nations. An analysis of the composition of the US's total trade reveals a striking shift. Since decoupling started to accelerate in 2018, China's share of US trade has suffered the largest contraction, falling by more than 14%. Traditional trading partners like Canada and Japan have also ceded ground.

The clear beneficiaries have been Vietnam, Taiwan, Mexico and India, each capitalising on the US-China rift by using their distinct competitive advantages. Vietnam has emerged as a primary destination for low-cost labour, attracting investment in electronics, textiles and machinery. Notably, its favourable business climate has also made it a destination for Chinese companies establishing satellite operations to circumvent US tariffs. Taiwan, in turn, plays a uniquely critical role. Its dominance in high-tech manufacturing, particularly advanced semiconductors, has made it not just an alternative but an indispensable trading partner. The surge in US imports from Taiwan reflects a strategic imperative to secure vital components from a global leader, a move that is less about "leaving China" and more about "derisking" a critical supply chain. Mexico leverages its formidable advantage of proximity. The benefits of nearshoring, such as faster shipping times and lower logistics costs, have fuelled growth in automotive parts, machinery and medical instruments.

Figure 5: US imports from all countries before trade war escalation vs current levels



Source: Bloomberg

Figure 6: Change in US exports before trade war escalation to current levels

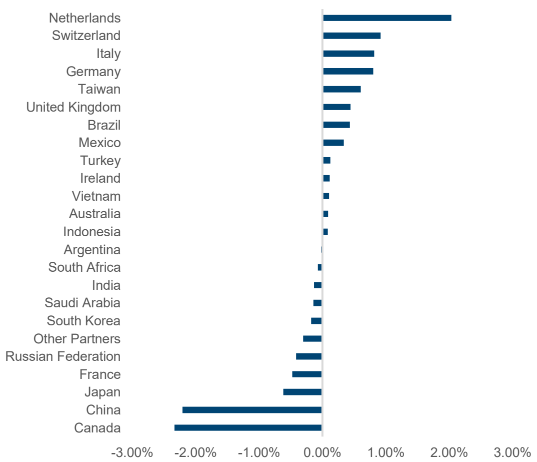
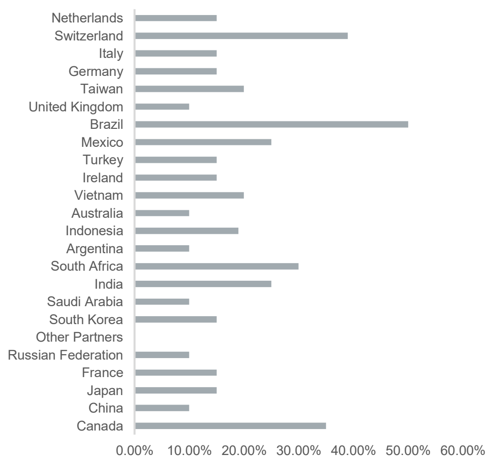


Figure 7: Effective tariff rate (August 2025)



Source: Bloomberg, BBC News

The direct arithmetic effect of a narrowing trade deficit with China is a net positive contributor to US GDP, as it improves the overall trade balance. Our analysis indicates that this improvement has added approximately 0.085% to GDP growth. While statistically positive, this magnitude remains too modest to drive a material economic shift on its own. However, the aggregate story is incomplete. The reallocation of trade to other partners carries a cost. The collective trade deficit with these sourcing nations has widened. When synthesised, this shift signals a larger aggregate deficit across redirected trade flows, which we estimate equates to a drag on overall US GDP growth of approximately 0.098% at current levels. This creates a neutral-to-slightly-negative net effect, underscoring that the primary implications of decoupling are microeconomic and strategic, such as supply chain resilience and inflationary pressure, rather than a dominant source of macroeconomic outperformance.

The US and China trade relationship is not dissolving; rather, it is undergoing a deep and strategic recalibration, moving from intertwined dependence to a more complex and managed competition; for instance, in negotiations. While the direct macroeconomic impact remains muted, the seismic shift in global supply chains and the reallocation of trade flows towards nations like Vietnam, Mexico and Taiwan reveal a new paradigm prioritising resilience alongside efficiency. This sets the stage for a critical, deeper analysis: to what extent can the world's two largest economies truly decouple, and what are the unforeseen consequences of attempting to sever such deeply rooted economic ties?

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